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IN THE

Supreme Court of the United States

OCTOBER TERM, 1941.

No. 29.

AMERICAN SURETY COMPANY OF NEW YORK,
Petitioner,

v.

THE BETHLEHEM NATIONAL BANK OF BETHLEHEM, PENNSYLVANIA, AND L. M. REED, AS RECEIVER OF THE BETHLEHEM NATIONAL BANK OF BETHLEHEM, PENNSYLVANIA,
Respondents.

BRIEF ON BEHALF OF THE UNITED STATES FIDELITY AND GUARANTY COMPANY AS AMICUS CURIAE.

W. PAGE DAME, JR.,
Attorney for United States
Fidelity & Guaranty Company,
as Amicus Curiae.

The Daily Record Co. Print, Baltimore.

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ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

BRIEF ON BEHALF OF THE UNITED STATES FIDELITY AND GUARANTY COMPANY AS AMICUS CURIAE.

STATEMENT.

Permission of Counsel for both sides first having been secured, in accordance with Rule 27, (9), of the Supreme Court of the United States, the United States Fidelity

and Guaranty Company files this brief herein as Amicus Curiae. The United States Fidelity and Guaranty Company is a Corporation of the State of Maryland, chartered especially to engage in the business of suretyship and, by reason of that fact and further because it itself has now pending an identical claim against another insolvent national bank, it is directly interested in the determination of this case.

I.

FACTS.

Since the facts of this case have been set out at length in the briefs for Petitioner and Respondents herein, they will only be summarized here.

To secure its deposit in the respondent bank, the Commonwealth of Pennsylvania received a surety bond in the amount of $125,000. with the Respondent Bank as principal and the Petitioner as surety. At the date of the closing of the bank the deposit secured by this bond was in the amount of $135,000.00. The Commonwealth recovered a portion of this deposit by the sale of bonds, which the bank had pledged with it as additional security, and recovered a further portion of the deposit from the payment by the Receiver of a first liquidating dividend in the amount of 40% of the whole deposit. The surety paid, therefore, the difference between the total of these two sums and the amount of the Commonwealth's deposit, such payment being in the amount of $68,588.56. Thereafter, the surety asserted the right to receive further dividends upon the basis of the entire deposit amount up until such time as such dividends might have repaid it the amount paid under its bond. The Receiver refused to pay dividends based on this amount but, instead, suggested various other amounts

upon which the dividend should be computed. Three further dividends have been paid by the Receiver to other creditors of the bank since payment of the initial dividend received by the Commonwealth; but, because of the dispute as to the proper basis upon which the Petitioner was to be paid, no portion of any of these dividends has been paid to the Petitioner. The Petitioner thereafter instituted this suit seeking to recover dividends upon the basis of the $135,000.00 deposit and for the recovery of interest thereon. The District Court in its decision held that the Petitioner was entitled to the dividends upon the basis alleged by the Petitioner, but, upon the appeal, the Circuit Court of Appeals for the Third Circuit reversed that decision holding that the dividends should be calculated and paid only on the basis of $68,588.56, the amount of the payment by the Petitioner to the Commonwealth.

II.

PRINCIPAL QUESTION PRESENTED FOR DETERMINATION BY THIS COURT.

May a Depository Surety for an Insolvent National Bank, who has made Depositor whole by a Payment of a less amount than that of the Deposit, be entitled by means of Subrogation to receive Dividends based upon the Full Amount of the Creditor's Deposit or shall it be Limited to Dividends upon the Amount of the Surety's Actual Payment?

It is the contention of the Petitioner that the surety in such a case should be entitled to receive dividends based upon the full amount of the deposit. The U. S. F. & G. Co. as Amicus Curiae entirely agrees with this view and submits that such result is in accordance with the settled law as laid down by this and other Courts.

III.

SUMMARY OF ARGUMENT.

In support of that decision, the following propositions are advanced:

(1) The Amount of any Claim Against an Insolvent National Bank for Dividend Purposes is fixed as of the date of the Closing of the Bank.

(2) Dividends Paid on All such Claims Shall be Ratable.

(3) No Equity exists on the Part of the Other Creditors of the Bank that would Prevent the Full Application of the Doctrine of Subrogation.

(4) All Dividends to which such Claim may be Entitled in Excess of the Amount Needed to Make the Depositor Whole are for the Benefit of the Surety, who by his Payment has Helped Satisfy the Depositor's Claim against the Bank.

IV.

ARGUMENT.

(1) The Amount of any Claim Against an Insolvent National Bank for Dividend Purposes is fixed as of the date of the Closing of the Bank.

It has been settled by numerous decisions of this Court that the amount of any claim against an insolvent bank for dividend purposes is fixed as of the date of the closing of the bank. *Merrill v. National Bank of Jacksonville* (1899), 173 U. S. 131; *White v. Knox* (1884), 111 U. S. 784. The creditors of the bank as of that date have a vested interest in its assets and no later transactions can in any manner operate to change the amount of any

claim as of the date of insolvency. In our case, therefore, on the date of insolvency the Commonwealth of Pennsylvania was a creditor of the bank to the extent of $135,000.00, the amount of its deposits. The Petitioner, on the other hand, had no claim whatsoever as of that time in any fixed amount as no payment of any sort had been made on behalf of the bank under its bond.

By its later payments to the Commonwealth, it did not reduce the amount of the Commonwealth's original proven claim. It simply acted as it was bound to act under its bond to repay that portion of the deposit which the bank, its Principal, had failed to pay.

In the case of *Maryland Casualty Company v. Cox* (1939), 104 Fed. (2d) 354, one of the cases most relied on by the respondents, the Circuit Court of Appeals for the Sixth Circuit considered a very similar situation to the one presented in this case and held that the surety should only be entitled to be subrogated to the extent of its payment. That Court, in its opinion at page 358, stated:

> "It does not follow, however, that the appellant on paying its obligation to the trustees acquired the right to collect the aggregate of their claims against the bank. It is as though the appellant had purchased a part of the debt. It did not pay the whole debt and is not entitled to collect upon the whole debt even though it may be subject to its portion of the debt the lien of the collateral which secures every part of it. Had the other sureties cancelled their obligations they too would under the theory of subrogation here advanced be entitled to claim dividends on the aggregate of the deposits. This cannot be the law."

In that case several sureties were involved, and the Court thus stated that to allow subrogation of each of the sureties to the aggregate amount of the deposit, might mean that two or three sureties would each be entitled to receive dividends on a claim equal to the amount of the whole deposit and to thus, in effect, make the bank pay on a far greater amount than it should. The error that, in our opinion, the Court committed, however, was in assuming that a surety, in thus paying a part of a claim, was purchasing a part of the original claim and was thus securing for himself, alone, one portion of the original total obligation. Nothing could be further from the fact as in no sense of the word is a surety, in making such a payment, purchasing a part of the debt. The surety is paying that balance which is yet outstanding after applying collateral and whatever dividends have been previously paid, and in so doing, it is fulfilling the duty that the bank owed to the depositor to repay the deposit in full. The bank still has the obligation to perform and to pay the original debt, but only the original debt—nothing more. The fact that one or more sureties will thus take the proceeds of that performance, however great or small it may be, does not affect the obligation of the bank to perform. If, in fact, more than one surety is involved, they will then apportion among themselves whatever the bank may pay on its primary obligation. They will not, and cannot, create additional claims upon which the bank must pay dividends.

So, here, the original debt is not affected. It stands as it did as of the date of insolvency, and there is no portion of it that has been subtracted from the whole to stand alone. The bank's obligation is unaltered, a new ultimate beneficiary of its performance being the only change.

The *Merrill* case, supra, settled the point that payment by means of realizing on collateral held by the depositor, did not change the original obligation, and certainly the payment of the depositor, by having him realize on the promise of a surety, likewise should not in any way affect the obligation of the bank to pay on the full amount of its primary debt.

(2) Dividends Paid on All such Claims Shall be Ratable.

The National Banking Act, *Revised Statutes, Section 5236, 12 U. S. C. A., Section 194,* states that "* * * the comptroller shall make a ratable dividend of the money so paid over to him by such receiver on all such claims as may have been proved to his satisfaction. * * *"

It would seem that the only way for a ratable dividend to be paid on the Commonwealth's deposit of $135,000 would be to keep that amount as the total of the bank's obligation as regards that deposit. That being done, it would make no difference as to the nature or number of the ultimate beneficiaries of the dividends paid. The depositor might continue to share in them until satisfied, and thereafter one or more sureties would receive them for their benefit, but as long as the original claim remains the same, everyone interested in that claim can be assured that it will always receive its ratable share of the assets of the insolvent.

When an attempt is made to alter the amount of the original claim after it has been proven, as was the case here, then to the extent of the alteration it will fail to get its ratable share of the dividends. It cannot be contended that the original claim has been satisfied in part and has survived in part, and at the same time, contend that the original claim is continuing to be ratably treated.

From the moment that any happening after insolvency is allowed to reduce the amount of the original claim, then at that time the proportionate value of such a claim in relation to the total value of claims filed, is undoubtedly altered. Any payments made thereafter could not be ratable because the basis for such distribution would be changed, and the other claims would receive proportionately more as the altered claim was given less.

It is the contention of the respondents:

> "That the fact that the principal has become insolvent and has been placed in liquidation proceedings does not permit enhancement of, or increase in, the face amount of the provable claim of the surety in the liquidation proceedings. As previously indicated, supra, page 6, the basis of reimbursement of the surety is measured by the amount he is required to expend for the benefit of the creditor under the bond" (Resp. Brief, p. 8).

It is entirely correct that the fact of insolvency itself should in no manner be permitted to enhance the amount of the surety's claim. Such a result is not sought in this case. The surety's claim is fixed at the amount which it has had to pay under its bond, but in an effort to recover that claim, it is proceeding under its right of subrogation to insist that the claim of its obligee be given fair and ratable consideration so that, to the extent of any further dividends paid, the surety would be thus reimbursed. The total amount recoverable by the surety is measured by the amount it is required to expend for the benefit of the creditor. Such amount recoverable, however, is not to be confused with the amount that should be used as the basis for the payment of dividends which go, in turn, to be credited on the amount recoverable by the surety. The amount recov-

erable by the surety need not be, and in most cases is not, the amount upon which the insolvent should pay dividends in order to satisfy, as far as possible, its original obligation to the creditor, and through the creditor, to the surety. The fact of insolvency, therefore, neither increases nor decreases the amount of the provable claim.

(3) No Equity exists on the Part of the Other Creditors of the Bank that would Prevent the Full Application of the Doctrine of Subrogation.

By operation of the doctrine of subrogation, the rights and remedies which a creditor has against the debtor to allow him to recover the debt vest in a surety paying such debt. This is done to thereafter enable the surety to make recovery from the debtor whose primary responsibility it is that such debt be paid.

Arant on Suretyship 360.
Stearns, Law of Suretyship (4th Edition) 426.
Sheldon on Subrogation (2nd Edition), Section 1.
60 C. J. 723, Section 35.

The doctrine, of course, is equitable in its nature and because of that fact, will not be applied where an inequitable result would be obtained. It is used to further a fairness of treatment among all parties concerned and any court, in applying it, must look to see that no innocent person's rights are prejudiced thereby. If, in this case, the other depositors of the bank could show that the application of this doctrine resulted in their being treated unfairly, then, of necessity, any court would refuse to fully apply it. However, such is not the case.

At the time of insolvency, certain obligations of the bank were in existence, and the relative position of all creditors was fixed by the amount of the claims against the insolvent at that time. If there had been no surety bond given the Commonwealth of Pennsylvania, the bank instead, would have had to secure the deposit entirely by the pledge of its own bonds, which it did only to a limited degree in this case. The Commonwealth of Pennsylvania would have then continued to the end of the liquidation proceedings to receive dividends upon the full amount of $135,000, and no creditor of the bank would have been heard to say that such result was prejudicial to his interests. It can be seen, therefore, that by the device of securing a surety bond, the bank was enabled to retain among its assets $125,000 worth of bonds which it otherwise would have been forced to pledge with the Commonwealth in order to give the Commonwealth the equal protection afforded by the surety bond. The surety bond, therefore, stands simply in lieu of the equal amount of collateral which the bank would have otherwise pledged so that the recovery under that surety bond should be considered precisely the same as recovery from other collateral pledged by the bank. Therefore, if the same dividends were paid on this claim, but were thereafter divided between the Commonwealth and its surety, no different method of treatment would be thereby accorded to the other creditors.

The Commonwealth was certainly entitled to file a claim for the entire amount of its deposit and, as a matter of fact, it was in duty bound to do so in order to fully protect the surety. Stearns in his "Law of Suretyship (4th Edition)" at page 451, says:

> "The right of the surety to insist upon the entire claim being proved seems clear for, if under these circumstances, the dividend is augmented so that together with what the surety has paid, the sum exceeds the debt, the surplus would belong to the surety by the application of the doctrine of subrogation."

and again at page 452:

> "It is held that where an insolvent dies or his assets are administered through insolvency proceedings, and a creditor holds collateral security for his debt upon which he realizes less than the amount of the debt, that he may prove his entire claim against the estate of the decedent or insolvent and make no account of the collateral until he is paid in full. Such right in the creditor carries a corresponding right to a surety in the application of the doctrine of subrogation."

The bond here is not, as is contended by the respondents, an asset which is to be utilized for the benefit of the bank's creditors in the event of insolvency. Such a contention would imply that the surety had simply given a policy of insurance to the bank, entitling the bank to collect the amount of the bond for the benefit of its general creditors in the event of insolvency. Clearly this is not the obligation of this bond. Neither the bank, itself, nor other creditors of the bank, can insist that any funds be paid into the hands of the receiver to augment the dividends payable to general creditors. The obligee of the bond, however, may insist that his individual debt be made good, as the essence of the surety's obligation is to see to it that a particular creditor is made whole if the bank is unable to repay the deposit. The surety, under no circumstances, need pay more under his bond than will satisfy that particular creditor. There is no obli-

gation to pay to the receiver of the bank or other creditors the full amount of its bond.

Counsel for the respondents, in arguing that this depository bond was an asset of the insolvent bank for the benefit of all creditors, attempted to support that theory by the citation of *United States Fidelity & Guaranty Company v. Wooldridge* (1925), 268 U. S. 234. In that case, the guaranty company had written a fidelity bond in favor of a bank covering the president of that bank, which bond agreed to refund the bank the amount lost through any dishonesty of its president. Such a bond, of course, as Justice Holmes stated in that case, is truly an asset of the bank for its whole number of creditors, as the bank, itself, was the obligee therein entitled to protection against, and reimbursement for, any defalcation on the part of the president which would cause financial loss to the bank. However, the depository bond involved in this case is one in which the bank is now the principal, the obligee being one of its depositors. The bank now is the one to perform—not to seek performance, and is in no manner entitled in and of itself to demand that any amount of money be paid into its hands to increase its assets for distribution to general creditors. The Commonwealth, as obligee, alone is entitled to any performance by the surety under this bond. It is, therefore, obvious that the *Wooldridge* case, supra, has absolutely no application with regard to the status of the bond involved here, as there is an utter dissimilarity in the obligation of the two bonds.

If the contention of the respondents be upheld in this matter, it would make for the most varying and fortuitous results in the repayment of any such surety, as the amount recoverable by a surety would then depend

upon the whims of the other parties to the transaction rather than upon such surety's inherent right of reimbursement. If, for example, the depositor should hold other collateral, the amount of the surety's recovery would vary depending upon whether or not such collateral was sold and applied to the debt prior to the time that the surety made payment; it again would vary should any dividend be paid the depositor prior to the time of the surety's payment. Certainly it is not the policy of the law to establish a doctrine which will result in such unequal treatment; but, on the other hand, the law should always strive to establish principles that will bring about uniform and certain treatment and which will avoid the element of chance and caprice of parties as far as possible. The Court in *In Re Thompson*, 300 Fed. 215, in holding that a paying surety was entitled to recover from an insolvent co-surety on the basis of the creditor's full claim, was motivated by its desire to seek just such uniform result, as it stated on page 217:

> "The application of this rule makes the rights of the paying surety fixed and certain instead of uncertain and depending on the caprice or election of the creditor to proceed, first against the insolvent or against the solvent surety, causing different results to the paying surety."

(4) All Dividends to which such Claim may be Entitled in Excess of the Amount Needed to Make the Depositor Whole are for the Benefit of the Surety, who by his Payment has Helped Satisfy the Depositor's Claim against the Bank.

By virtue of the fact that several parties will participate in sharing the proceeds from a proven claim, the debtor's obligation to pay that claim to the fullest extent possible is unchanged, and when dividends have made

whole the primary creditor or obligee, he then retains any further dividends in the capacity as trustee for the surety or sureties who have made him whole.

U. S. F. & G. Company v. McClintock, 26 Fed. (2d) 944.

Fouts v. Maryland Casualty Company, 30 Fed. (2d) 357. (C. C. A., Fourth Circuit, Cert. denied, 279 U. S. 852).

Young v. Gordon, 219 Fed. 168 (C. C. A., Fourth Circuit).

To the same effect, see:

Hanson v. Tyler Auto. Company, 286 Fed. 161.

Oakland County v. Central West Casualty Company (Mich.), 254 N. W. 158.

Minshull v. American Surety Company (Wash.), 252 Pac. 147.

In the last cited case the right of the surety to receive dividends on the entire indebtedness of the principal appears to have been allowed, although, as in the case at bar, proceeds from collateral held by the obligee had been applied in part payment of the deposit, the balance having been paid by the surety on the depository bond and the surety on the official bond of the county treasurer. The sureties were allowed to pro rate dividends paid on the *entire* amount of the deposit.

The Court in the *Fouts* case, supra, stated on page 359 that the surety, through subrogation, "should receive all dividends payable to the state treasurer over and above the amount added to the casualty companies payment on the bond necessary to satisfy his claim."

Certainly if such method of reimbursement of the surety has been approved, there would seem to be no reason to prevent such dividends being paid directly to any surety rather than have them paid first to the

creditor and by the creditor thereafter turned over to the surety. There is nothing in the procedure involved in having the dividends pass through the hands of the creditor which would give the surety a greater right to ultimately receive them simply because they had made this detour on the way to him. If the contention of the respondents here be upheld, certainly the rule as laid down in such cases as these would be entirely overturned.

V.

CONCLUSION.

It is therefore respectfully submitted that in order to pay a ratable dividend on the claim of the Commonwealth of Pennsylvania which was fixed in amount for the purpose of dividends as of the date of insolvency, *Merrill v. National Bank of Jacksonville, supra,* it will be necessary to allow the Commonwealth's surety to receive dividends based on the amount of that deposit up until the time that the surety has been reimbursed for the amount that it has paid under its bond. To hold otherwise we contend would be to destroy the fundamental requirement of the law; namely, that dividends on all such claims shall be ratable and, therefore, we believe that the decision of the United States Circuit Court, Third Circuit, is erroneous and should be reversed, and that the decision of the United States District Court for the Eastern District of Pennsylvania is correct and should be sustained.

Respectfully submitted,

W. PAGE DAME, JR.,
Attorney for United States
Fidelity & Guaranty Company,
as Amicus Curiae.

SUPREME COURT OF THE UNITED STATES.

No. 29.—October Term, 1941.

American Surety Company of New York, Petitioner,
vs.
The Bethlehem National Bank of Bethlehem, Pennsylvania, and L. M. Reed, as Receiver of the Bethlehem National Bank of Bethlehem, Pennsylvania.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Third Circuit.

[December 8, 1941.]

Mr. Justice Frankfurter delivered the opinion of the Court.

The facts of this case are simple. The Commonwealth of Pennsylvania had $135,000 on deposit in the Bethlehem National Bank. This deposit was secured by a $125,000 bond, upon which the plaintiff was surety, and by a pledge of government bonds having a par value of $12,000. The bank became insolvent, and a receiver was appointed. Thereafter the Commonwealth obtained, in round figures, $12,500 from the sale of the collateral and $54,000 as a 40% dividend on its claim, a total of $66,500. The remaining $68,500 was paid by the surety, thereby fully satisfying the Commonwealth's claim. The present suit arose out of three further dividends, of 20%, 10%, and 5%, respectively, declared by the receiver. The surety sought dividend payments on the basis of the original indebtedness, that is, $135,000. The receiver insisted that the extent of the surety's participation must be measured by the sum actually expended to discharge its principal's obligation, to wit, $68,500. Reversing the decision of the District Court, 33 F. Supp. 722, the Circuit Court of Appeals for the Third Circuit upheld the receiver's contention. 116 F. 2d 75. In view of conflicting expressions by the lower courts upon a question so important in the liquidation of national banks, cf. *Maryland Casualty Co.* v. *Cox*, 104 F. 2d 354; *Ward* v. *First National Bank*, 76 F. 2d 256; *Fouts* v. *Maryland Casualty Co.*, 30 F. 2d 357, we brought the case here. 312 U. S. 677.

The National Bank Act provides for the "ratable" distribution of assets of insolvent national banks. R. S. § 5236; 12 U. S. C. § 194. The question for decision is therefore one of federal law. *Deitrick* v. *Greaney*, 309 U. S. 190, 200-01; *Merrill* v. *National Bank of Jacksonville*, 173 U. S. 131; *Davis* v. *Elmira Savings Bank*, 161 U. S. 275; *Cook County Nat. Bank* v. *United States*, 107 U. S. 445, 448. Congress has seen fit not to anticipate by specific rules solution of problems that inevitably arise in national bank liquidations. Instead, it chose achievement of a "just and equal distribution" of an insolvent bank's assets through the operation of familiar equitable doctrines evolved by the courts. *Davis* v. *Elmira Savings Bank*, 161 U. S. 275, 284; *Jenkins* v. *National Surety Co.*, 277 U. S. 258, 267. Among the oldest of these doctrines is the rule of subrogation whereby "one who has been compelled to pay a debt which ought to have been paid by another is entitled to exercise all the remedies which the creditor possessed against that other". Sheldon, Subrogation (2d ed.) § 11; see *Hampton* v. *Phipps*, 108 U. S. 260, 263; *Hodgson* v. *Shaw*, 3 Myl. & K. 183, 191; *Hayes* v. *Ward*, 4 Johns Ch. 123, 130.

Here the surety was compelled to pay to the Commonwealth $68,500 which ought to have been paid by the bank. Of course it succeeds to the Commonwealth's right to receive payment of $68,500 from the bank—and in no event can the surety receive more. But as a means of enforcing this right the Commonwealth was entitled to share in all future dividends on the basis of its original claim of $135,000. *Merrill* v. *National Bank of Jacksonville*, 173 U. S. 131. Succeeding to the creditor's right, the surety also succeeds to the creditor's means for enforcing it. The surety is a special kind of secured creditor. For its claim against the principal is secured by its right of subrogation to the remedies of the creditor which it has been compelled to pay. Of course, this right can be availed of only by a surety alert in discharging its duty, *Jenkins* v. *National Surety Co.*, 277 U. S. 258, 267, and one not guilty of inequitable conduct, *United States* v. *Ryder*, 110 U. S. 729, 737. In other respects a right of subrogation is as much in the nature of a security as is a mortgage.

A "ratable" distribution requires that dividends be declared proportionately upon the amount of all claims as they stand on the date of the insolvency. This is settled law. *White* v. *Knox*, 111 U. S. 784, 787; *Merrill* v. *National Bank of Jacksonville*, *supra*, at

143; *Ticonic Bank* v. *Sprague*, 303 U. S. 406, 411. "The distribution is to be 'ratable' on the claims as proved or adjudicated, that is, on one rule of proportion applicable to all alike. In order to be 'ratable' the claims must manifestly be estimated as of the same point of time, and that date has been adjudged to be the date of the declaration of insolvency". *Merrill* v. *National Bank of Jacksonville, supra*, at 143. The basis of participation in the bank's assets by the Commonwealth was $135,000, the amount of the claim on the date of insolvency. The amount of the claim having been thus fixed on the date of insolvency, it did not shrink because of the extraneous circumstance of the creditor's forethought in securing partial satisfaction of its loss by going against the collateral and the surety.

To permit the surety to stand in the shoes of the secured creditor whose claim it has paid does not prejudice the rights of the general creditors. The extent of their participation in the distribution of the Bank's assets was fixed on the day it became insolvent. The surety will receive no greater share than would have been received by the Commonwealth had it not been for the circumstance that its claim was secured by a surety's bond. If, for one reason or another, the surety had withheld payment to the Commonwealth, the latter would have continued to receive dividends on the full amount of its claim, or if, on a nice calculation, the surety had at the outset satisfied its principal's obligation, it would have been entitled to share on the basis of the full amount. On the other hand, if the surety's participation should be limited to the extent now urged by the receiver, the other creditors would profit solely because of fortuitous circumstances and without any relation to reasons of intrinsic fairness. The extent of the participation of the surety, and therefore that of the other creditors, would depend on how, when, and against whom the secured creditor presses its claim. Cf. *In re Thompson*, 300 Fed. 215, 217-18; *Pace* v. *Pace*, 95 Va. 792, 799. Such a result leaves too much to caprice or accident and is wholly at variance with the guiding criterion of "ratable" distribution.[1]

[1] Reflecting the special policy of bankruptcy legislation favoring the general creditor against the secured creditor, the rule prevails in bankruptcy that dividends upon the claims of secured creditors "shall be paid only on the unpaid balance." § 57(h), 30 Stat. 544, 560, 11 U. S. C. § 93(h); 14 Stat. 517, 526. It is settled, however, that the "bankruptcy" rule is inapplicable to the distribution of assets of insolvent national banks. Merrill v. National

A final consideration needs mention. The receiver cites several instances in which the Comptroller of the Currency has stated that the basis of a surety's claim is to be measured by the amounts it has expended. But there is wanting here any long-continued practice which establishes its own law within the permissible area of administrative action. Cf. *Inland Waterways Corp.* v. *Young*, 309 U. S. 517, 524-25.

Reversed.

A true copy.

Test:

Clerk, Supreme Court, U. S.

Bank of Jacksonville, 173 U. S. 131. There is no occasion to reexamine the correctness of that decision, the authority of which has never been questioned here and was again recognized very recently. Ticonic Bank v. Sprague, 303 U. S. 406, 412. Although the National Bank Act has been amended many times since its original enactment in 1864, 13 Stat. 114, the provision governing distribution of dividends has remained substantially intact. The construction given the provision in the Merrill case has been left unchanged by Congress.

SUPREME COURT OF THE UNITED STATES.

No. 29.—October Term, 1941.

American Surety Company of New York, Petitioner,
vs.
The Bethlehem National Bank of Bethlehem, Pennsylvania, and L. M. Reed, as Receiver of the Bethlehem National Bank of Bethlehem, Pennsylvania.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Third Circuit.

[December 8, 1941.]

Mr. Justice Douglas, dissenting.

The only virtue possessed by *Merrill* v. *National Bank of Jacksonville*, 173 U. S. 131, is the fact that it has been on the books for over forty years. It held that a secured creditor could receive dividends on the face amount of his claim even though that claim had been reduced by the value of the collateral between the date of insolvency and the date of distribution. That rule of distribution is inequitable and unfair to the run of depositors. It gives an advantage to the secured creditor unwarranted by any provision of his contract. For it treats the claim as wholly unpaid even though it has been partially discharged by liquidation of the collateral. The impact on other creditors is oppressive. Under the rule of the *Merrill* case a depositor with a $10,000 claim, secured by $5,000 worth of collateral, will be wholly paid if the insolvent bank pays a 50% dividend. On the other hand, an unsecured depositor with a $10,000 claim salvages under those circumstances only $5,000. A rule of distribution which sanctions such a discriminatory result violates the requirement for "ratable" dividends prescribed by the National Banking Act. R. S. § 5236, 12 U. S. C. § 194. This is no occasion, however, to elaborate on the point. It was fully covered in its historical and legal aspects by the dissenting opinions of Mr. Justice White and Mr. Justice Gray in the *Merrill* case.

The majority of the Court was of the view that whatever might be the power of Congress under the bankruptcy clause of the Con-

stitution, the adoption of the bankruptcy rule[1] in equity would be an invasion of "prior" contract rights (173 U. S. at p. 146)—an impairment of obligation of contract. And the reason for that conclusion was based on the theory that since "the creditor's rights in the trust fund are established when the fund is created, collections subsequently made from, or payments subsequently made on, collateral, cannot operate to change the relations between the creditor and his co-creditors in respect of their rights in the fund." (p. 140.) For that reason it was held that the claims of creditors are to be "determined as of the date of the declaration of insolvency". (p. 147.) There is serious question whether that foundation has not been swept away by *William Filene's Sons Co.* v. *Weed*, 245 U. S. 597.

Mr. Justice Holmes stated in the *Weed* case (p. 602): "But when the courts without statute take possession of all the assets of a corporation under a bill like the present and so make it impossible to collect debts except from the court's hands, they have no warrant for excluding creditors, or for introducing supposed equities other than those determined by the contracts that the debtor was content to make and the creditors to accept. In order to make a distribution possible they must of necessity limit the time for the proof of claims. But they have no authority to give to the filing of the bill the effect of the filing of a petition in bankruptcy so as to exclude any previously made and lawful claim that matures within a reasonable time before distribution can be made."

That theory runs counter to the assumption in the *Merrill* case (173 U. S. at p. 136) that a creditor acquires a "vested interest in the trust fund" antedating distribution. For if that assumption were valid, the claim in the *Weed* case, which had matured

[1] It should be noticed that the bankruptcy rule, now codified (Bankruptcy Act § 57(h), 11 U. S. C. § 93(h)), which allows the secured creditor to receive dividends only on the balance remaining after the value of the security has been deducted from the claim, did not derive from a special statutory provision. As pointed out by Mr. Justice Gray in his dissent in the *Merrill* case (173 U. S. at pp. 174-175) the Bankruptcy Act of 1841 (5 Stat. 440) had no such provision. Yet its requirement for "pro rata" distribution (§ 5) was recognized by Mr. Justice Story, its draftsman, as permitting a secured creditor to prove only for the balance of his claim as remained after crediting the value of the security. Ex parte City Bank of New Orleans, 3 How. 292, 315. That rule of construction followed the long established English bankruptcy rule. See Mr. Justice White, dissenting, 173 U. S. at pp. 153-155. As stated by Lord Eldon in Ex parte Smith, 2 Rose Bank. Rep. 63, 64, until the secured creditor's claim has been reduced by deducting the value of the security "it is impossible correctly to say what the actual Amount of it is."

after the proceedings had been instituted, would have been disallowed. Such an assumption would likewise fail to take heed of the admonition of Mr. Justice Holmes that "supposed equities other than those determined by the contracts that the debtor was content to make and the creditor to accept" are not to be recognized.

Yet, assuming *arguendo* that the premise of the *Merrill* case has survived, the answer to the proposition that application of the bankruptcy rule would result in impairment of obligation of contract was completely answered by Mr. Justice White (173 U. S. at p. 152): " . . . the preferential right arising from the contract of pledge is in nowise impaired by compelling the creditor to first exercise his preference against the security received from the debtor, and thus confine him to the specific advantage derived from his contract. Further, however, as the contract, construed in connection with the law governing it, restricts the secured as well as the unsecured creditor to a ratable dividend from the general assets, the secured creditor is prevented from enhancing the advantage obtained as a result of the contract for security, by proving his claim as if no security existed, since to allow him to so do would destroy the rule of ratable division, subject and subordinate to which the contract was made." And see Glenn, Liquidation (1935) § 530.

This analysis of the *Merrill* case is germane to the present problem not merely to focus the historical setting of the rule which we are asked to enforce. It is especially important because we are now asked to extend that rule to a special type of *unsecured* creditor.

The surety who seeks its protection has an *unsecured* claim for $68,500. It seeks to gain the advantages which a secured creditor with a claim of $135,000 would have, i. e. the right to receive dividends on that basis. To deny the surety that preference would be no invasion of "prior contract rights", no impairment of obligation of contract, under the theory of the majority in the *Merrill* case. This surety neither has nor had any claim which was secured. Nor did it have any fixed and liquidated claim at the date of the declaration of insolvency. Its claim was always unsecured and it matured, as in the *Weed* case, after the appointment of the receiver. Nevertheless, this surety, though it would fail to gain the preferred position of a secured creditor under the test of the

Merrill case, is allowed to reach that position through the back door of subrogation.

It is ordinarily true that a surety succeeds to all of the rights and remedies of the creditor including the latter's priority. *Lidderdale's Executors* v. *Executor of Robinson,* 12 Wheat. 594. But that is no inexorable rule. As this Court stated in *Memphis & Little Rock R. R. Co.* v. *Dow,* 120 U. S. 287, 301-302, "The right of subrogation is not founded on contract. It is a creature of equity; is enforced solely for the purpose of accomplishing the ends of substantial justice." In determining whether it would be fair or equitable to allow the subrogation to the full extent of the creditor's rights and remedies, consideration will, of course, be given to the prejudice, if any, suffered by other creditors. But the mere fact that the other creditors will not be worse off than if the surety's principal had pressed the claim is not the sole solvent of the problem. We are not dealing with a mechanical rule. The question remains whether justice requires or policy permits the surety to succeed to his principal's privileged position.

Such considerations frequently are a barrier to any subrogation; at other times they may cut down the rights of the surety and give him less than his principal could exact. Illustrations of the former are *German Bank* v. *United States,* 148 U. S. 573, where subrogation was denied because it arose from conduct which was tortious; and *United States* v. *Ryder,* 110 U. S. 729, where a surety on recognizance bail was denied subrogation to the rights of the United States. In the *Ryder* case subrogation was denied because, *inter alia,* its allowance "would be to aid the bail to get rid of their obligation, and to relieve them from the motives to exert themselves in securing the appearance of the principal. Subrogation to the latter remedies would clearly be against public policy by subverting, as far as it might prove effectual, the very object and purpose of the recognizance." *Id.,* p. 737.

Closer in point, however, are those cases which award the surety less rights than his principal had. Thus *South Philadelphia State Bank's Insolvency,* 295 Pa. 433, held that while a surety was entitled to be subrogated to the rights of a State against an insolvent bank, the surety did not in absence of statute[2] acquire the

[2] By statute a surety of the United States succeeds to the latter's priority. R. S. § 3468, 31 U. S. C. § 193. It should be noted, however, that though the United States has priority against an insolvent (R. S. § 3466, 31 U. S. C. § 191) that priority has been held not to extend to an insolvent national bank. Cook County Nat'l Bank v. United States, 107 U. S. 445.

State's priority. See Arnold, An Inequitable Preference in Favor of Surety Companies, 36 W. Va. L. Q. 278; (note) 81 U. Pa. L. Rev. 441. The theory of that case is that "the State's right to a preference over other creditors, being a sovereign right enjoyed for the benefit of all the people, cannot be transferred to individuals except by express legislative sanction." (p. 440.) Though that case represents the minority view in the state courts,[3] it is recognition of the healthy principle that application of the rule of subrogation should not be reduced to a conceptualistic formula.

The sweep of that principle is illustrated by *Memphis & Little Rock R. R. Co.* v. *Dow, supra.* In that case the prior lien creditor had a claim with interest at 8%. To allow the surety the same rate of interest would not have put the junior lienor in a worse plight. But this Court disallowed that rate, pointing out (120 U. S. at p. 302) that the surety was entitled only to reimbursement. A similar approach in this case would be to ascertain the equities of the surety's claim not by looking for the principal's rights under its contract but for reasons why this surety should be accorded priority over other unsecured creditors. Equity has regard not only for the rights of other creditors (*Jenkins* v. *National Surety Co.*, 277 U. S. 258) but also for the stake which the surety has and which it is asking a court of equity to protect. A court of equity should neither "come to the aid of one" whose equity is "subordinate until claims superior in equity" have been satisfied (*American Surety Co.* v. *Westinghouse Electric Mfg. Co.*, 296 U. S. 133, 136), nor create superior equities on behalf of one who can show no more compelling reasons for preferred treatment than can those with whom he competes. Under such an approach this surety would be denied a superior equity.

Here the surety has only an unsecured claim of $68,500. Any reason for continuation of the discrimination against the general depositors of this bank disappeared when the surety's creditor was paid. No equity has been suggested for allowing this surety preferred treatment. It was paid to assume the risk of insolvency of the bank. It was paid by the bank itself. And it has not been shown that it charged a lower rate because of the rule of the *Merrill* case. In view of those circumstances it should not be allowed the lion's share. It is entitled to reimbursement but certainly in no

[3] See Arant, Suretyship (1931), p. 363.

greater an amount than the run of depositors. It is no answer to say that such a result would give the general depositors a windfall. Unless subrogation is to be a mechanical formula, this surety should be required to establish its special equity to preferred treatment—reasons why it unlike any other unsecured creditor should enjoy the benefits of the discriminatory rule of the *Merrill* case.

Finally, it is suggested that if the surety is not allowed this preference, much will be left to "caprice or accident", since the surety would have been entitled to share on the basis of the full amount if it had satisfied the creditor's obligation at the very outset. The answer to that is that we would then have to determine whether the *Merrill* case has survived the *Weed* case (See Clark, Proof by Secured Creditors in Insolvency and Receivership Proceedings, 15 Ill. L. Rev. 171) and if so, whether it should be overruled. It is sufficient at this time to say that in view of the flimsy basis on which the *Merrill* case rests and the oppressive nature of the rule it fashioned, it should not be extended.

Mr. Justice BLACK concurs in this dissent.